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IN THE

# Supreme Court of the United States

OCTOBER TERM 1970

No.

FIRST NATIONAL BANK IN PALM BEACH AND PHILLIP D. O'CONNELL, CO-TRUSTEES OF A TRUST CREATED BY THE WILL OF MICHAEL A. KELLY,

Petitioners,

versus

UNITED STATES OF AMERICA,

Petition for Writ of Certiorari to the United States Court of Appeals For The Fifth Circuit

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1970

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No. _____

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FIRST NATIONAL BANK IN PALM BEACH AND PHILLIP D.O'CONNELL, CO-TRUSTEES OF A TRUST CREATED BY THE WILL OF MICHAEL A. KELLY,

Petitioners,

v.

UNITED STATES OF AMERICA

---

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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To the Chief Justice and the Associate Justices of the Supreme Court of the Unites States:

Your Petitioners, First National Bank in Palm Beach and Phillip D. O'Connell, Co-Trustees of a Trust Created by the Will of Michael A. Kelly, hereby petition for a writ of certiorari to review the decision of the United States Court of Appeals for the

Fifth Circuit holding that the value of a remainder interest bequeathed to charity was not "presently ascertainable" on the date of Michael A. Kelly's death because of certain normal administrative powers granted your Petitioners in their capacities as Trustees, and the resultant disallowance of a charitable deduction for the value of the remainder interest in computing the taxable estate of the Estate of Michael A. Kelly for purposes of the federal estate tax.

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit and the opinion of the United States District Court for the Southern District of Florida have not yet been officially reported. They are unofficially reported at 1971 P-H p. 148,598 and at 25 A.F.T.R.2d 70-1588, respectively. These are appended hereto as Appendices A. and B., respectively.

## JURISDICTION

The decision sought to be reviewed in this case was entered by the United States Court of Appeals for the Fifth Circuit on May 7, 1971. No petition for rehearing was filed and no request was made for an order granting an extension of time within which to petition for certiorari. The statutory provision believed to confer on this Court jurisdiction to review the judgment or decree in question is 28 U.S.C. §1254(1).

## QUESTION PRESENTED FOR REVIEW

1. Whether administrative powers given by a trust instrument to independent Trustees holding assets for the benefit of a

charitable remainder-man, after an intervening life estate in favor of a noncharitable beneficiary, which powers must be exercised in a fiduciary capacity, constitute indirect powers of principal invasion so as to preclude the value of the remainder from being presently ascertainable?

## STATUTES AND REGULATIONS INVOLVED

26 U.S.C. §2055

(a) In General.--For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers,***

* * * *

(2) to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes,***

26 C.F.R. §20.2055-2 Transfers not exclusively for charitable purposes--(a) Remainders and similar interests. If a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest. The present value of a remainder or other deferred payment to be made for a charitable purpose is to be determined in accordance with the rules stated in §20.2031-7. Thus, if money or property is placed in trust to pay the income to an individual during his life, or for a term of years,

and then to pay the principal to a charitable organization, the present value of the remainder is deductible.***

## STATEMENT OF THE CASE

By Item IV of his Last Will and Testament, Michael A. Kelly, hereinafter referred to as Decedent, left the residue of his estate to Petitioners in trust to pay the greater of the net income or $100.00 per week to his sister, Mary DeMola, during her lifetime (said payments to be made out of principal if required), and to distribute the remainder to a religious organization. As of the date of death, the income anticipated by the trust was more than sufficient to make the required payments to Mrs. DeMola, and no principal invasion would be required to meet this obligation.

By Item VII(c) of Decedent's Will, his Trustees were given certain discretionary powers. As herein pertinent, those powers can be summarized as follows:

> "(4) Pay, in their discretion, premiums on bonds or other securities which they may purchase*** [in which event] ***the entire interest or income therefrom shall be paid to ***[the income beneficiary]***without deduction for the amortization or recoupment of such excess."
>
> "(5) Invest and reinvest the principal of my estate and/or of any of the trusts***in any form of investment which they, in their sole and absolute discretion, shall determine***"

> "(9) Determine, in any case where doubt exists under the facts or applicable law, whether any charges, expenses or disbursements incurred or paid by them shall be charged against the principal or income***"
>
> "(10) Treat any extraordinary dividends payable in any stock or other securities, and also any liquidating dividends, as income and not as principal, or partly as income and partly as principal*** provided, however, that in any case where doubt exists under the facts or applicable law, the determination of my***[Trustees]*** as to whether any dividends shall be apportioned or allocated in whole or in part to principal or income, and their apportionment or allocation thereof, shall be conclusive and binding upon***said trust and upon all persons interested therein."

The trust is administered by Petitioners as independent Trustees, one being a corporate fiduciary and the other being an individual who has no beneficial interest in the trust estate.

A charitable deduction was claimed in the United States Estate Tax Return, Form 706, filed on behalf of Decedent's estate in an amount equal to the value of the remainder interest. The District Director of Internal Revenue determined that no deduction was allowable for such amount, and a deficiency was assessed and paid. After complying with the statutory requirements relating to Claims for Refund, a suit was

instituted in the United States District Court for the Southern District of Florida to recover an overpayment of federal estate taxes on the grounds that the estate was entitled to deduct the value of the charitable remainder in computing its federal estate tax. The basis for federal jurisdiction in the Court of first instance was 28 U.S.C. §1346(a)(1).

The District Court held for the Petitioners and entered a judgment against the United States of America. This was reversed by the United States Court of Appeals for the Fifth Circuit. The decision of the Court of Appeals was predicated upon its opinion that the Trustees could invade corpus through the exercise of administrative powers in a manner that would favor the life tenant, and that, notwithstanding the fiduciary obligations of the Trustees to all beneficiaries, the mere existence of such a possibility prevents the value of the remainder from being presently ascertainable.

## POINTS RELIED ON FOR ALLOWANCE OF THE WRIT

### POINT I

The question involved is an important issue of federal law, which has not been, but should be settled by this Court.

The question involved in cases deciding this issue is whether administrative powers to be exercised by a Trustee acting in a fiduciary capacity are to be treated as powers of principal invasion for purposes of the Internal Revenue laws. Although most pending cases involving this issue are concerned with the deductibility of the value of a remainder interest to charity, after

an intervening life estate in favor of a noncharitable beneficiary, the scope of the doctrine now being advanced by the Internal Revenue Service is not so limited. Neither is the doctrine being advanced limited to those factual situations where the powers are of such magnitude as to suggest indirect control of principal. For the most part, these cases involve nothing more than normal administrative powers, many of which were probably taken from legal forms of long standing, that are designed solely to facilitate the administration of trust estates.

The issue involved in cases of this type can best be described by a review of the decisions of this Court involving the deductibility of the value of remainder interests to charity. This Court has seen fit to review this problem on five occasions. In so doing, it set forth the two standards that must be satisfied to obtain the benefit of the deduction. One standard is that the possibility that the charity will not take must be so remote as to be negligible. The cases establishing this standard are Humes v. United States (1928) 276 U.S. 487 and Commissioner v. Sternberger's Estate (1955) 348 U.S. 187. In both of those cases, the charitable bequest was subject to a contingency, and there was a possibility that the charity would take nothing. Consequently, the deduction was denied. This standard is not involved in this case, or any other case involving the question here presented, since the Internal Revenue Service concedes that the possibility that the charity will not take is so remote as to be negligible.

The remaining three cases decided by this Court were concerned with the second

standard, that is, if there is a possibility of principal invasion, it must be fixed in fact and capable of being stated in terms of money. In Merchants National Bank of Boston v. Commissioner (1943) 320 U.S. 256, the trust in question permitted invasion for happiness and enjoined the Trustee to be liberal, and in Henslee v. Union Planters National Bank and Trust Company (1949) 335 U.S. 595, the trust permitted invasion of corpus to take care of the beneficiary "*** in such manner as she may desire***". In both cases, this Court held that the power permitting principal invasion "***did not limit the Trustees' disbursements to conformity with some ready standard***", and denied the deduction.

In the third case, this Court held in favor of the taxpayer. In Ithaca Trust Company v. United States (1929) 279 U.S. 151, this Court was concerned with a power of principal invasion which permitted the Trustee to suitably maintain the beneficiary "***in as much comfort as she now enjoys". This Court considered outside evidence of financial circumstances to establish that there was little likelihood of principal invasion, and allowed the deduction. In so doing, it held that the power of principal invasion was based on an ascertainable standard, such being the beneficiary's then comfort.

This was the state of the law until recently. An individual knew the rules. If he wished to receive the benefit of a charitable deduction for the value of a remainder interest to charity, he could not include contingencies that might preclude the charity from receiving anything. If he wished to hedge by giving the power to invade principal

for the benefit of the life tenant, he would have to limit that power by an ascertainable standard. Lastly, he knew that the Courts would look at outside evidence to determine the likelihood of substantial principal invasions even if the standard was ascertainable. What he did not know was that he could not give his Trustee normal administrative powers to facilitate the administration of the trust estate.

In recent years, as demonstrated by cases involving the issue here presented, the Internal Revenue Service has extended the "presently ascertainable" rule to deny the deduction where administrative powers give the Trustee any discretionary powers of allocation. In so doing, it has refused to consider outside evidence as to how the powers would be administered, including the presumption that a Trustee will act in good faith and deal impartially as between the life tenant and the remainderman.

More specifically, in the instant case, the life beneficiary was to receive the greater of the income or One Hundred ($100.00) Dollars per week, and the parties agreed by stipulation that the income would be sufficient to satisfy this charge. Even if not sufficient, the power of principal invasion is clearly stated in definite terms of money, and is thus fixed in fact.

Notwithstanding this, the Internal Revenue Service determined, and the United States Court of Appeals for the Fifth Circuit held, that the Trustees could encroach on the principal of the trust by favoring the life tenant, and that this possibility precluded the valuation of the remainder from being presently ascertainable. In so

doing, it refused to consider the fact that the Trustees would show impartiality between the two beneficial interests, holding that such fact is of no consequence where there is a legal possibility that the Trustees will exercise their powers to encroach upon corpus. In effect, the Court of Appeals considered not what was likely but what was remotely possible, and in so doing rejected the doctrine established by this Court in Ithaca that when the power of invasion is fixed by an ascertainable standard, the Court should look to actual likelihood and not to conjecture. Obviously, if this Court had looked to conjecture in Ithaca, it would have denied the deduction since the beneficiary could have lost her outside resources.

The holding in this case leaves the hypothetical testator in a dilemma. Can a Trustee be given any discretionary power? In this case, the Court of Appeals felt that a provision enabling the Trustees to allocate receipts and disbursements between income and principal "where doubt exists under the facts or applicable law", was a basis for encroachment of principal that would result in a denial of the deduction. Must the testator provide that the Trustee must go to a local Court for a decision where doubt exists? Would this be sufficient? Is it not possible to construct a conjectural hypothesis on conceivable Court rulings? Is there, therefore, such a thing as a presently ascertainable value for a remainder interest? This is a subject that should be considered by this Court.

## POINT II

**The decision of the Court of Appeals is in conflict with a decision of this Court.**

In the Ithaca case, the trust instrument gave the Trustee, who was also the beneficiary, the power to make investment decisions. In the lower Court opinion, reported at 64 Ct.Cl. 686, the Court of Claims placed great stress on the conjectural possibility that the Trustee might make investment decisions favoring the life tenant. This Court reversed, notwithstanding the existence of this possibility, noting only that this created "***no uncertainty appreciably greater than the general uncertainty that attends human affairs." This Court found that the standard governing principal invasions was fixed in fact and capable of being stated in definite terms of money, and that under the factual circumstances there was little likelihood of it being exercised. On the basis of these findings, the deduction was allowed.

In this case, the administrative powers are somewhat different but the theory is the same. The Trustees here could administer the trust in such a manner as to favor the income beneficiary. They could embark on a program of buying bonds at a premium, investing only in liquidating corporations (when such could be found), or investing in high yield securities with a substantial risk of principal loss. On the other hand, they could invest in growth securities and thus favor the remainderman. However, the possibility that they would do either, in violation of their duty to deal impartially, was virtually nonexistent. This possibility created "***no uncertainty appreciably

greater than the general uncertainty that attends human affairs."

In this case, the power of direct principal invasion is fixed in fact and capable of being stated in definite terms of moeny in that it is stated in definite terms of money -- One Hundred ($100.00) Dollars per week out of income or principal if necessary. The evidence also establishes that under the factual circumstances here involved, the income was sufficient to meet this charge, and thus there is little likelihood of there being any direct principal invasions. This meets the requirements established by this Court in the Ithaca case.

The Court of Appeals for the Fifth Circuit rejected the Ithaca doctrine by refusing to allow the deduction where the power to directly invade principal was fixed in fact and the circumstances established that there was little likelihood that it would be exercised. In lieu thereof, it followed the approach of the Court of Claims in Ithaca and looked to what could happen if the Trustees elected to follow a pattern of favoring the life beneficiary through use of their administrative powers. In so doing, it based its decision solely on conjectural possibilities as opposed to actual facts. This approach was condemned by this Court in Ithaca.

## POINT III

**The basis of the decision by the Court of Appeals in this case is in conflict with decisions by the United States Courts of Appeals for the First and Third Circuits.**

The decision of the Court of Appeals

for the Fifth Circuit in this case is in conflict with the decision by the United States Court of Appeals for the Third Circuit in Peoples Trust Company of Bergen County v. United States (3rd Cir. 1971) ___F.2d ____, unofficially reported at 1971 P-H p. 148,639, and with the decision of the United States Court of Appeals for the First Circuit in Old Colony Trust Company v. United States (1st Cir. 1970) 423 F.2d 601.

In Peoples Trust Company, the question involved was identical with the question involved in the instant case -- that is, whether the value of a charitable remainder was unascertainable and hence nondeductible because of certain administrative powers in the trust instrument. Factually, the administrative powers in the cited case were substantially greater than those given the Trustees in the instant case, and there was a real probability of corpus distributions because the Trustee was directed to treat capital gain distributions by mutual funds as income. The Third Circuit, however, held that the Trustee's duty of impartiality provided sufficient safeguards and allowed the deduction.

It is recognized that the Third Circuit attempted to distinguish its decision from two decisions rendered by the Fifth Circuit on the grounds that there was a difference between the laws of the governing jurisdictions, New Jersey in the cited case and Florida in the Fifth Circuit decisions. This attempted distinction has no basis in law. Although it went to great lengths to avoid a direct holding in this regard, the Fifth Circuit recognized in The Miami Beach First National Bank v. United States (5th

Cir. 1971)____F.2d____, unofficially reported at 1971 P-H p. 148,577 (which was a companion case to this one) that a Florida Trustee does have the obligation to deal impartially as between successor beneficiaries. In any event, it is clear that such is the law in Florida. Sanders v. Richard (Fla. 1895) 16 So. 679. Such recognition was also apparent in the opinion in this case. Thus, there is a conflict in that the Third Circuit has held that the fiduciary obligations impose sufficient safeguards to protect the charitable remainderman whereas the Fifth Circuit has held that they are not.

Similarly, although not involving the deductibility of the value of a charitable remainder, the rationale in this case is in conflict with the rationale of the First Circuit in Old Colony Trust Company v. United States. In the cited case, the question was whether the retention of administrative powers was, in effect, a right to designate who shall enjoy the trust property within the meaning of 26 U.S.C. §2036(a)(2). The government's position in that case was substantially identical with its position in the instant case, that is, that the powers could be exercised in a manner favoring either the life tenant or the remainderman, which in its view required the includability of the property in the gross estate.

The First Circuit held for the taxpayer on this particular question. The Court based its holding on the conclusion that the Trustees were subject to fiduciary obligations and that such provided sufficient control. Although this case also discusses state law, the conclusion that fiduciary obligations provide sufficient control is contrary to the holding of the Fifth Circuit

in this case.

Other cases involving this same issue that are currently being litigated include Estate of Lillie MacMunn Stewart v. Commissioner of Internal Revenue (3rd Cir. 1971) 436 F.2d 1281, petition for certiorari filed; Gardiner v. United States (D.Ariz. 1969) unofficially reported at 24 A.F.T.R. 2d 6108 (appeal pending C.A. 9th); Estate of Harry A. Toulmin, Jr. v. United States (S.D.Ohio 1971), unofficially reported at 27 A.F.T.R.2d ____, ¶147,560 (appeal pending C.A.6th).

## CONCLUSION

This Court should grant certiorari, and the judgment below should be reversed.

Respectfully submitted,

Robert O. Rogers
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## CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of July, 1971, three copies of the foregoing Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit, were served upon the Solicitor General, Department of Justice, Washington, D. C. 20530, by mailing said copies by United States mail, postage prepaid to the address indicated above.

Robert O. Rogers
Attorney for Petitioners

APPENDIX A

IN THE

# United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 29453

FIRST NATIONAL BANK IN PALM BEACH and PHILLIP D. O'CONNELL, Co-Trustees of a Trust Created by the Will of Michael A. Kelly,

Plaintiffs-Appellees,

versus

UNITED STATES OF AMERICA,

Defendant-Appellant.

*Appeal from the United States District Court for the Southern District of Florida*

(May 7, 1971)

Before TUTTLE, AINSWORTH and SIMPSON, Circuit Judges.

TUTTLE, Circuit Judge: This is a companion case with *Florida National Bank at Lakeland, etc. v. United States,* ____ F.2d ____ decided April ____, 1971 and *The Miami Beach First National Bank, etc. v. United States,* ____ F2d ____ decided April ____, 1971 in the sense that it deals with the allowability of a deduction from gross estate for estate tax purposes of a *remain-*

der to admitted charitable purposes in light of certain investment and management powers given to the trustees. The government claims these powers of investment and management authorized the trustees to invade the corpus to a degree appreciable enough to prevent the interest from being "presently ascertainable, and hence severable from the non-charitable interest" Regs. 20.2055-2a. The trial court found "the value of this charitable remainder was presently ascertainable" and entered judgment for the taxpayers for the amount which they had paid.

As we have heretofore discussed in the two companion cases, the principle to be applied in determining the deductibility of charitable remainders has been carefully delineated in four Supreme Court cases, *Ithaca Trust Company v. United States*, 279 US 151 (1929); *Merchants Bank v. Commissioner*, 320 US 256 (1943); *Henslee v. Union Planters Bank*, 335 US 595 (1949); *Commissioner v. Sternbergers Estate*, 348 US 187 (1955), where, at page 199, the court said there must be "assurance that charity will receive the bequest or some *determinable* part of it" (emphasis added) to justify the deduction.

We deal here with §2055a of the Internal Revenue Code of 1941[1] and the applicable regulations.[2] The ef-

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[1]This section (26 USCA 2055a) provides in part:

(a) *Remainders and similar interest. If a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the non-charitable interest.* The present value of a remainder or other deferred

payment to be made for a charitable purpose is to be determined in accordance with the rules stated in Sec. 20. 2031-7. Thus, if money or property is placed in trust to pay the income to an individual during his life, or for a term of years, and then to pay the principal to a charitable organization, the present value of the remainder is deductible. To determine the present value of such remainder use the appropriate factor from column 4 of Table I or Table II of Sec. 20.2031-7, whichever is applicable. * * *

(b) *Transfers subject to a condition or a power.* If, as of the date of decedent's death, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, *no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible.* If an estate or interest has passed to or is vested in charity at the time of a decedent's death and the estate or interest would be defeated by the performance of some act or the happening of some event, the occurrence of which appeared to have been highly improbable at the time of the decedent's death, the deduction is allowable. *If the legatee, devisee, donee, or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent, the deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of the power.* * * * (Emphasis added.)

[2]The applicable sections are: (Regs. 20.2055-2(a) )

"Where a trust instrument provides that the trust income shall be paid to a life tenant, that the corpus may be invested in stock of regulated investment companies, and that dividends received by the trustees which represent capital gains realized from the sale of securities owned by such companies shall be treated as corpus and held for the benefit of a charitable remainderman, then the charitable remainder interest is severable from the noncharitable interest, and its present worth may be ascertained. The present worth of such a charitable remainder is deductible for income, estate, and gift tax purposes in the manner and to the extent provided in sections 170, 2055 and 2522 of the Internal Revenue Code of 1954.

However, if the trust instrument provides that dividends representing capital gains realized as aforesaid shall (or, in the trustee's discretion, may) be treated as income and paid to the life tenant, or if the

fect of the statute and regulations, as applied by the courts, is that a deduction for a charitable remainder is not allowable unless the interest is "presently ascertainable, and hence, severable from the non-charitable interest". (Regs. 20.2055a), which the Supreme Court defined as "fixed in fact and capable of being stated in definite terms of money." Ithaca Trust Co., *supra* at page 154; it is not deductible unless "the possibility that the charitable transfer will not become effective is so remote as to be negligible".

Against this conceded legal standard we must measure the remainder designated to religious purposes in this will. The relevant portions of the will are: the will as amended by codicil created a trust of the decedent's residuary estate, which was valued at death as $183,052.00. The trustees were to distribute the net income from this trust to decedent's 54 year old sister for life — with a guaranteed minimum of $100.00 per week.[3] Upon the death of the life beneficiary the corpus of the trust was to be paid over to the charitable beneficiary. Other relevant provisions of the will are as follows:

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instrument could be so construed under applicable local law, then the charitable interest is not severable from the noncharitable interest since no known formula has been advanced for ascertaining the value of the charitable interest. Therefore, no deduction for income, estate, or gift tax purposes is allowable with respect to the transfer."

[3]The trial court determined that this minimum could be maintained without direct encroachment on the corpus. The government does not appeal from this determination. It was, in fact, stipulated that the income would "exceed $5,200 per year" for the sister's expectance of 20.47 years.

(a) Wherever in this, my Will, the words "my Executors" or "my Trustees" are used, such words shall be deemed to mean, refer to and include my Executors, or, as the case may be, my Trustees herein named, and their and each of their successors or successor.

(b) Wherever in this subdivision (b) or in subdivision (c) of this ITEM VII the words "my Executors" are used, such words shall be deemed to mean, refer to and include my Executors, and my trustees herein named, and their and each of their successors or successor.

(c) In addition to the powers, authorities, discretions and immunities now or hereafter given to executors and trustees by law, and in amplification (but not in limitation) thereof, I authorize and empower my Executors, in their sole and absolute discretion, to:

* * * *

(4) Pay, in their discretion, premium on bonds or other securities which they may purchase, and, in case my Executors shall purchase for or hold in my estate or any of the trusts hereby created any bonds or other securities at a cost or value in excess of the principal amount thereof, the entire interest or income therefrom shall be paid to the respective persons entitled to receive the income of the fund whereof such bonds or securities form a

part, without deduction for the amortization or recoupment of such excess.

(5) Invest and reinvest the principal of my estate and/or of any of the trusts hereby created, or any part thereof, or any accumulated income, in any form of investment which they, in their sole and absolute discretion, shall determine, and I direct that they shall not be restricted to investments of the nature and kind prescribed by law for the investment of trust funds; and I further direct that they shall not be liable or responsible to any person or persons interested in my estate or in any of said trusts for any depreciation in or loss of principal or income occasioned by any such investment of principal or by the retention thereof.

* * * *

(9) Determine, in any case where doubt exists under the facts or applicable law, whether any charges, expenses or disbursements incurred or paid by them shall be charged against the principal or the income of my estate or any of the trusts hereby created, and the extent or proportion of any such charge, expense or disbursement which is to be charged against principal and/or income, and I direct that the judgment and decision of my Executors with respect thereto shall be conclusive and binding upon my estate and said trusts and upon all persons interested therein.

(10) Treat any extraordinary dividends payable in any stock or other securities, and also any *liquidating dividends*, as income and not as principal, or partly as income and partly as principal, but ordinary dividends paid in any stock or other securities regularly by a corporation in lieu of, or in addition to, regular cash dividends, and all dividends accumulated on any preferred stock after receipt or acquisition of such preferred stock by by Executors shall, if declared, be considered income and not principal, provided, however, that in any case where doubt exists under the facts or applicable law, the determination of my Executors as to whether any dividends shall be apportioned or allocated in whole or in part to principal or income, and their apportionment or allocation thereof, shall be conclusive and binding upon my estate and said trusts and upon all persons interested therein. (Emphasis added.)

The government highlights several provisions of this will which, it claims, either direct, or give the trustees discretion, to invade the corpus of the trust for the benefit of the life tenant.

The first of these is the authority given in subparagraph (c) above "in amplification (but not in limitation) to the powers, authorities, discretions and immunities now or hereafter given to executors and trustees by law . . . in their sole and absolute discretion, to ". . . buy bonds and other securities at a premium,

in which event "the entire interest or income therefrom *shall* be paid to the life beneficiary without deduction for the amortization or recoupment of such excess." (Emphasis added) As an illustration as to how this provision could result in reducing corpus in favor of the life beneficiary we need to look only to one of the assets received by the executors at the death of the decedent. At that time he owned a $10,000 bond of the Standard Oil Company of Indiana. It was valued for estate tax purposes at $11,408.33. If this bond was held until maturity and the trustees did not amortize the premium, the corpus of the trust would suffer a loss of $1,408.33. Moreover, the trustees were given complete authority to invest and reinvest in securities of this kind, so that they might, by the literal authorization of the will, "pay, in their discretion, premiums on bonds" and they would then be entitled to pay the entire income from the bonds "without deduction for the amortization or recoupment of such excess." A further power to encroach on the corpus of the estate existed in the provision of paragraph 10, supra, which authorized the trustees to "treat any exordinary dividends payable in any stock or other securities . . . as income and not as principal" with the further provision that "the determination of my executors as to whether any dividends shall be apportioned or allocated in whole or in part to principal or income, and their apportionment or allocation thereof, shall be conclusive and binding upon my estate and said trusts and upon all persons interested therein." Under this provision, of course, the executors had full authority to treat stock dividends paid by companies in which the executors held stock as income rather than as ac-

cretions to corpus, which they really are. It is recognized in the Florida law and the uniform Principal and Income Act. Florida Statutes Annotated §690.06, that "stock dividends should inure to the benefit of the corpus." Stock dividends, of course, are merely a redistribution of the number of shares representing the assets of a corporation. Certainly, to the extent that stock dividends represent appreciation in the value of the underlying assets of the corporation, rather than income to it they represent accretions to principal.

Moreover, the decedent also authorized the trustees expressly to treat "liquidating dividends" as income. Obviously, the distribution of a dividend by distributing the assets of a corporation on its dissolution is a distribution of principal. Nevertheless, this will expressly authorized the trustees to treat these dividends as income. The trial court found that "liquidating dividends, indeed, involved a return of capital." However, the court said "but here again, the possibility that the trust corpus will be affected to any significant degree is remote." Principally, however, the trial court seemed to base its judgment on the following statement: "further, notwithstanding the broad powers conferred by the instrument, the trustees are charged with the duty of prudent and good faith management of the trust, from an investment stand point, and are fiduciaries of the remainderman as well as the life tenant. It must be presumed, therefore, that the trustees could not and would not arbitrarily and capriciously hinder the interest in the remainderman in this manner."

We have stated in the case of *The Miami Beach First National Bank v. United States of America*, supra, it is clear that when extraordinary powers of this kind are given to the fiduciary they are intended to modify the general rule with respect to the obligations to a fiduciary to deal with an even hand with respect to the life tenant as against the remainderman when no such extraordinary powers are expressed. However, as illustrated by the Florida case of *Wallace v. Julier*, 3S2d 711, the Florida courts recognized the power of a decedent expressly to authorize his trustees to favor a life tenant by permitting the trustees to classify and distribute "accretions and increases" to the life tenant, notwithstanding the general obligation of a fiduciary in the absence of such extraordinary powers as are given in this will.

We find nothing in general fiduciary law nor the laws of Florida that would cause the courts to intervene if the trustees in the exercise of the powers given in this will were to do precisely what the will authorized them to do with respect to the distribution of liquidating dividends to the life beneficiaries if they received any during the administration of the trust.

We think the rule to be applied here is well stated by Scott in §233.5. See III Scott, Trusts, §233.5:

> By the terms of the trust the trustees may be empowered to determine what receipts should be treated as income and what receipts as principal or to apportion receipts between income and principal, * * *. Where such a

> power is conferred upon the trustee, his determination is controlling unless he has abused the discretion conferred upon him. Whether there is an abuse of discretion depends upon the extent of the power conferred upon him. *The mere fact that the trustee does not follow the rules which would be applicable if no such power were conferred upon him does not constitute an abuse of discretion. Indeed, the very purpose in conferring the power upon him is to enable him to depart from the usual rules.* (Emphasis added.)

A further basis for encroachment on the corpus in favor of the life tenant is that provision of the will which authorizes the trustees to "determine, in any case where doubt exists under the facts that or applicable law, whether any charges, expenses or disbursements incurred or paid by them shall be charged against the principal or the income of my estate or any of the trusts hereby created." We have already seen the powers mentioned here are stated by the testator to be "in addition to the powers, authorities, discretions and immunities now or hereafter given to executors and trustees by law *and in amplification (but not limitation)*." As we stated in the *Miami Beach First National Bank case, supra,* the power to charge trustees commissions, taxes on income and any property or intangible taxes that may be levied against the estate to principal rather than income clearly permits an invasion of corpus. The appellees here clearly concede in their brief "appellees do not contend that the trustees could not exercise their discretion and allocate

some receipt that are normally classified as principal to income or vice versa. Neither do they contend that such would not have any effect on the amount that charity eventually receives." This concession, however they say does not affect the result because "the same is true of investment decisions. It is only submitted that it is presumed that these trustees will act in good faith and such is all that is required." It is our view that appellees failed to comprehend the requirement that fiduciaries "act in good faith." There can be no contention that trustees are not acting in good faith if they honestly exercise authority expressly granted by the will.

The appellees read too much into the quoted decision of *Wallace v. Julier*, supra.

> "The discretions . . . vested . .. [in trustees will] . . . not be interferred with or controlled by the courts so long as it is honestly and reasonably exercised by him but the will does not confer an arbitrary or capricious authority. If it appears from the conduct of the trustee that he is disposing of the rents, income, and profits, not in carrying out the purpose of the trust, but in selfish disregard of the claims of other beneficiaries, so that the design of the other testatrix is defeated, then it is the duty of the court to interfer. . . ."

As pointed out by Scott, supra, "the very purpose in conferring the power upon [the trustee] is to enable him to depart from the usual rules." In fact, the

Florida Supreme Court in the *Julier* case directed that the discretionary power given to the trustees to consider what would normally be corpus, that is to say, "accretions or increases" as income be given effect, although trustees dealing even handedly between life tenants and remainderman would not be permitted to convert what was truly corpus into what was interest. The court very properly determined that when the trustees carry out an extraordinary discretion in the manner which was not inconsistent with the obvious purpose of the testator, they were not in violation of the standard of fairness and good faith.

Lest it be thought that the courts approval of the chancellors disallowance of a charge made by the trustees in the *Julier* case against income instead of charging it against corpus is inconsistent with what we have said here, we call attention to the fact that nowhere in the report of the *Julier* case does it appear that the will, which was there before the court for construction, expressly authorized the trustees to treat expenditures, costs and charges against the estate in accordance with their full and complete discretion, as is contained in paragraph 9 of this will. The court, therefore, doubtless was applying the general rule that where trustees made an improper charge against the life tenants for an item of expenditure that should, by good faith and even handed dealing as between the two successive beneficiaries, have been charged to principal, because no express authorization permitted them to do otherwise, such an allocation would be set aside by the courts.

In sum, we conclude that the trustees here could in the best of faith in carrying out recognized fiduciary principles invade corpus in the manner suggested above to a material extent which, though not measurable, would make impossible the valuation in dollar amounts of the remainder interest that would be left to go to the named charities.

The appellees here have an alternative basis for contending that a substantial deduction for charitable purposes should have been allowed by the trial court, even were the full amount of the remainder not deductible as we have found to be the case here. This alternative claim was not reached by the trial court, because that court determined that the charitable deduction, as contended for by the executors, should be allowed. The alternative claim, briefly stated, is that the decedent Kelly and his friend, one McNamara, had in 1938 executed a mutual contract to make wills, which contract, it is contended, as amended by subsequent amendment, provided that each party would leave his residuary estate to the other in exchange for the other's agreeing to leave his entire estate to certain designated charities. McNamara died in 1954 and his estate was distributed to Kelly, the decedent here, in accordance with McNamara's will and in accordance with the contract. Subsequently, Kelly executed the will with which we are concerned. This will, although leaving what may turn out to be a very substantial remainder to charity, is quite dissimilar from that agreed upon in the contract, did not contain direct bequest of the entire estate of decedent to the named charities. During the period of probate of this will the executors filed a suit

for declaratory judgment, seeking instruction of the appropriate Florida court in connection with the contract to execute joint wills. All parties who could conceivably have an interest in either the estate or the proceeds from the contract were notified of the pendency of the litigation, and the record discloses, without more, that on February 23, 1965 an order was entered in the court of the county judge in and for Palm Beach County Florida, stating that a proposed settlement was consented to and approved by the parties in interest and was to the best interest of the estate; whereupon, it was ordered adjudged and decreed that the executors effect settlement with two out of the four religious orders referred to in the original contract, by the payment to each of these two the sum of $42,000, that is to say, a total of $84,000. The order further provided that the executors "shall obtain, in exchange for said payments, a stipulation for a decree adverse to the said parties claims against this estate. . ."

In substance, the trustees of the estate contend that the sum of $84,000 should be deducted from the estate for estate tax purposes under the charitable deduction provisions, regardless of whether the provisions giving the remainder to the other religious charity is recognized.

The government counters on the ground that the alternative claim was not mentioned as a basis for the claim for refund, contended by the government to be a necessary prelude to the prosecution of a successful claim. See *Angelus Milling Co. v. Commissioner*, 325 U.S. 293 (1945) and *Alabama By-Products Corp. v. Pat-*

*terson*, 258 F2d 892, 900 (1958). To this contention the appellees respond that the government did not object at the time of the pre-trial hearing or at any time during the hearing in the trial court to the alternative claim, other than to object to any testimony relating to it on the ground that it was not "relevant" to the only issue before the court.

The parties, of course, differ further with respect to what effect is to be given to a payment made pursuant to litigation seeking specific performance of a contract to execute a will; it being contended by the government that any amounts paid out in satisfaction of such a contention would be the payment of a "claim against the estate" and not satisfaction of a bequest or a gift under the will; the appellees, of course, contending exactly to the contrary, that under the Florida law if the contract is recognized the persons taking under it take as bequests under the will.

While the equities strongly favor the recognition by the tax gatherer of the undisputed fact that the estate actually has been reduced to the extent of $84,000 by payments to undisputed charitable purposes[4] there remain, unfortunately, a number of problems relating to the actual disposition of the matter litigated in the state court that it would appear improper for us to attempt to resolve issue on appeal. For instance, although neither party suggests this in briefs now before

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[4]Equities so strong, in fact, that it may not be inappropriate for the court to suggest that the Internal Revenue Service may conclude with the taxpayer that there is some basis for settlement or adjustment of this issue upon remand.

us, a glance at the actual terms of the contract appear on the surface only to require that Mr. Kelly make an outright bequest to the named charities *if his death should occur within 90 days of the death of Mr. McNamara.* This, of course, did not happen. In fact it was not until after 90 days following the death of McNamara that Mr. Kelly made the will with which we are now concerned. The Kelly life beneficiaries raised this point in the case pending in the county court of Palm Beach County. Since the trial court did not give any consideration to the validity of the contract to execute wills (it appearing not to have been executed with the formality required for a will in the state of Florida) nor whether the contract, if properly executed and binding, was actually breached by Mr. Kelly, and the court not having undertaken to pass upon the issue of a possible waiver by the government of any objection of the failure to include the alternative claim in the claim for refund, we think that as to the alternative claim the case must be REMANDED to the district court for further disposition. It should be said, of course, that by mentioning certain aspects of the contract matter, we express no opinion as to what disposition should be made by the trial court of this alternative claim.

The judgment of the trial court is REVERSED and the case is REMANDED for further proceedings not inconsistent with this opinion.

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APPENDIX B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

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| FIRST NATIONAL BANK IN PALM BEACH AND PHILLIP D. O'CONNELL, CO-TRUSTEES OF A TRUST CREATED BY THE WILL OF MICHAEL A. KELLY, | ) | No. 68-1096-CIV-EC |
| Plaintiffs | ) | Filed Aug 22, 1969 |
| v. | ) | |
| UNITED STATES OF AMERICA, | ) | |
| Defendant | ) | |

FINDINGS OF FACT AND
CONCLUSIONS OF LAW

This is an action for the refund of federal estate taxes and interest collected by the defendant from the First National Bank in Palm Beach and Phillip D. O'Connell, as Co-Trustees of a testamentary trust created by the will of Michael A. Kelly. This cause was submitted to the Court on an agreed statement of facts as contained in the pre-trial stipulation filed herein on May 2, 1969. The Court approves and adopts the facts as stipulated and thereupon renders its decision.

1. Both parties agree that the issue of law is whether the value of a charitable remainder interest could be presently ascertained on the date of decedent's death so as to qualify the remainder interest for

a charitable estate tax deduction under §2055 of the Internal Revenue Code of 1954.[1] The provisions of the will that are relevant to this issue are as follows:

> Item IV of Codicil - If my sister, MARY DEMOLA, now residing in New York, New York, shall survive me, I Give, Devise and Bequeath all the Rest, Residue and Remainder of my property, real or personal, movable or immovable, of whatsoever kind, nature and description, and wheresoever situate or being, and whether acquired before or after the making of this Will, of which I may die seized or possessed, or that shall be capable of testamentary disposition by me to my Trustees hereinafter named, IN TRUST, to hold, invest and reinvest the same, to receive the income therefrom and to pay the net income therefrom, by way of weekly installments to my sister, MARY DEMOLA, so long as she shall live, and, in the event the net income therefrom shall not be sufficient to permit the payment of at least One Hundred ($100.00) Dollars per week, then my Trustees are authorized and directed, in their sole judgment, to use and apply so much of the principal, then being held by them, as will, together with the said net income, permit payment to my said

1/ Plaintiffs' alternative issue will be discussed infra.

sister of at least One Hundred ($100.00) Dollars per week. Upon the death of my said sister, my Trustees are hereby directed to distribute the Trust Estate then remaining, absolutely and free of trust, to FRANCES CARDINAL SPELLMAN, Archibishop of New York, or, if he shall not then be surviving, then to his successor, to be used by him, in his sole judgment, for the general welfare and development of the Catholic Faith within the Archdiocese of New York.

If my said sister, MARY DEMOLA, shall not survive me, then, and in said event, I Give, Devise and Bequeath all of the aforesaid Rest, Residue and Remainder of my property to FRANCIS CARDINAL SPELLMAN, Archbishop of New York, or, if he shall not then be surviving, then to his successor, to be used by him, in his sole judgment, for the general welfare and development of the Catholic Faith within the Archdiocese of New York.

Trustees Powers -

(4) Pay, in their discretion, premiums on bonds or other securities which they may purchase, and, in case my Executors shall purchase for or hold in my estate or any of the trusts hereby created any bonds or other securities at a cost or value in excess of the principal amount thereof, the entire interest or income

therefrom shall be paid to the respective persons entitled to receive the income of the fund whereof such bonds or securities form a part, without deduction for the amortization or recoupment of such excess.

Trustees Powers -

(10) Treat any extraordinary dividends payable in any stock or other securities, and also any liquidating dividends, as income and not as principal, or partly as income and partly as principal, but ordinary dividends paid in any stock or other securities regularly by a corporation in lieu of, or in addition to, regular cash dividends, and all dividends accumlated on any preferred stock after receipt or acquisition of such preferred stock by my Executors shall, if declared, be considered income and not principal, provided, however, that in any case where doubt exists under the facts or applicable law, the determination of my Executors as to whether any dividends shall be apportioned or allocated in whole or in part to principal or income, and their apportionment or allocation thereof, shall be conclusive and binding upon my estate and said trusts and upon all persons interested therein.

2. Mary Demola, the life beneficiary of the trust, has survived the decedent.

3. By Item IV of decedent's will, decedent left the residue of his estate to his Co-Trustees to pay the greater of the net income of $100.00 per week to his sister, Mary Demola, during her lifetime (said payments to be made out of principal if required), and to distribute the balance to or for the Archbishop of New York to be used by him for the general welfare and development of the Catholic Faith in the Archdiocese of New York. The parties have stipulated that the beneficiary of the remainder interest is a person described in §2055(a)(3). Defendant does contend, however, that the value of the remainder interest was not presently ascertainable on the date of death, and thus no part of the value thereof is allowable as a deduction.

4. If a trust is created for both a charitable and a private purpose, a charitable deduction is allowable (1) if the value of the charitable interest is presently ascertainable, Regs. §20.2055-2(a); and (2) the possibility that the charitable transfer will not become effective is so remote as to be negligible. Regs. §20.2055-2(b). In this case, the question presented is the former, i.e. whether the value of the charitable remainder could be presently ascertained on the date of decedent's death. If presently ascertainable on that date, the estate is entitled to a charitable deduction with respect thereto under §2055.

5. Defendant first contends that the provision of the will that empowers the Co-Trustees to invade corpus in order to pay Mary Demola "at least" $100.00 a week renders the amount of the charitable remainder unascertainable. Defendant asserts that the

language of the will creates a floor to the amount to be paid rather than a ceiling; that it does not prohibit larger distributions.

6. Defendant's asserted construction of this will contravenes the natural and reasonable meaning of the words used. The will first provides that the life tenant is to receive the income from the trust in weekly installments. If, however, that income is insufficient to permit payment of "at least" $100.00 per week, the Co-Trustees can apply so much of the principal that will, together with available trust income, permit a payment of "at least" $100.00. It is the second use of the words "at least" that creates the difficulty.

7. Certainly the payments might exceed $100.00 per week from income alone, perhaps to a considerable degree. But the Co-Trustees are not empowered to invade the corpus unless and until the income is insufficient to permit a $100.00 installment. The provision in the will that allows payment of "at least" $100.00 a week from a combination of principal and income cannot be read out of context. Under defendant's construction, if the income was $99.00 per week, then the trustees' power would come into play and would permit a distribution of any amount, from principal and income, as long as it was "at least" $100.00. If, on the other hand, the income was $101.00 per week, the trustees could not invade the corpus at all, and the beneficiary would be limited to that amount. Defendant correctly suggests that there would be no dispute if the words "at least" were deleted from the empowering clause. However, the testator's intent, when the

provision is read as a whole, is clear: the trustees are empowered to distribute at least $100.00 per week regardless of income, but are required to distribute all the income. They are not authorized to distribute in excess of $100.00 per week from principal.

8. Thus, it is clear that the trustees' power to invade corpus for the benefit of the life beneficiary does not render the value of the remainder presently unascertainable. The very most of principal that could be invaded would be $5,200.00 per year.

9. In this regard, the parties have stipulated that as of the date of death, the net income (determined in accordance with generally accepted accounting principles in the State of Florida) that could be anticipated from the residuary estate was an amount in excess of $5,200.00 per year. In effect, the defendant concedes that the possibility of invading principal at all was remote.

10. While an ascertainable standard for invasion of principal must be determinable from the terms of the document (as it is here), the Court may look to extrinsic facts to determine the probability of invasion under that standard. See generally, Mertens, Federal Gift and Estate Taxation, §28.40 (1959). Here, the possibility of invasion is so remote as to be neglible. The existence of the power would not render the value of the remainder unascertainable, and, because of the factual improbability that there will be any invasion for private use, the value of the remainder would not be diminished thereby.

11. Defendant next contends that the powers conferred upon the trustees by items 4 and 10 of the will caused the charitable remainder to be unsusceptible of valuation on the date of death. Neither of those provisions involves invasion of corpus, per se, but rather the treatment of interest on dividends as principal or income.

12. The first provision authorizes the trustees to receive interest or income on bonds that were purchased at a premium without amortization or recoupment of the premium. The second provision allows the trustees to treat extraordinary and liquidating dividends as income rather than principal. Generally speaking, it is defendant's position that because the above items are traditionally treated, at least in part, as principal, the existence of the power to classify same as income renders the value of the corpus (remainder) presently unascertainable.

13. Presumably, defendant's theory has its genesis in Rev. Rul. 60-385. There it was announced that if a trustee had the power to invest in a regulated investment company and, further, to treat any capital gains realized as income rather than principal, then "the charitable interest is not severable from the non-charitable interest since no known formula has been advanced for ascertaining the value of the charitable interest."

14. Defendant's theory is, in general, sound. A gain realized by virtue of the appreciation in value of a principal asset is properly attributable to principal. But assuming that capital gains could, under

the trust instrument, be treated as income, this fact would not necessarily render the present value of the corpus unascertainable. Thus, extraordinary dividends, even in stock of the declaring corporation, would not, if treated as income, diminish the value of the corpus.

15. The fact that the trustees need not amortize bond premiums is similarly of no significance. From an income tax standpoint, §171 allows an individual taxpayer (including fiduciaries of trusts and estates) to elect to amortize. A decision to amortize is binding and, in essence, is one of investment judgment. See Mertens, Federal Income Taxation, §23.167 (1966). And, although amortization of premiums is considered a "sound accounting principle", the fact that the trustees might disregard that principle would not render valuation of the corpus unascertainable.

16. The only matter left is the trustees' power to treat liquidating dividends as income. Liquidating dividends indeed involve a return of capital. But here again, the possibility that the trust corpus will be affected to any significant degree is remote. Further, notwithstanding the broad powers conferred by the instrument, the trustees are charged with the duty of prudent and good faith management of the trust, from an investment standpoint, and are fiduciaries of the remainderman as well as the life tenant. It must be presumed, therefore, that the trustees could not and would not arbitrarily and capriciously hinder the interest of the remainderman in this manner.

17. In addition to the foregoing,

defendant's contention that "there is no difference between ascertaining principal for purposes of determining the value of an income interest (gift taxes) and ascertaining principal for purposes of determining the value of a charitable remainder (estate taxes)" should be mentioned. The courts have not taken this approach. Where it has been possible, in estate tax cases, to ascribe a minimum value to the remainder interest (corpus) the courts have not hesitated to do so. Valuation of the present interest (income) is not necessary. In gift tax cases, however, the income interest must be valued as well, and the courts have not allowed the taxpayer to rely on a minimum valuation approach regarding the present and the future interest. See Evans v. Commissioner 198 F2d 435, 437 (3 Cir. 1952). Thus, invasion of corpus for the "comfort and support" of the life beneficiary is generally held to present an ascertainable standard for valuation in estate tax cases[2], but not in gift tax cases[3]. Thus, many of the cases relied on by defendant are not in point.

18. The value of this charitable remainder was presently ascertainable, under the principles here announced, and is deductible and therefore plaintiffs are entitled to a refund. Pursuant to paragraph IV (g)

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2/ See Nardi v. U.S. 385 F2d 343 (7 Cir. 1967) and cases cited.

3/ See Funkhouser's Trusts v. C.I.R. 275 F2d 245 (4 Cir. 1960) and cases cited.

of the pre-trial stipulation the parties shall submit an agreed form of judgment (or if they should fail to agree, written notice of that fact) within thirty days from the entry hereof.

19. In view of the Court's ruling, it is unnecessary to consider plaintiffs' alternative theory of recovery.

DONE AND ORDERED at Miami, Florida, this 22nd day of August, 1969.

EMETT C. CHOATE
Senior United States District Judge